COSTAR ECONOMY

Labor Market Continues To Cool as Demand for Workers Eases

But Wage Growth Still Outpaced Inflation

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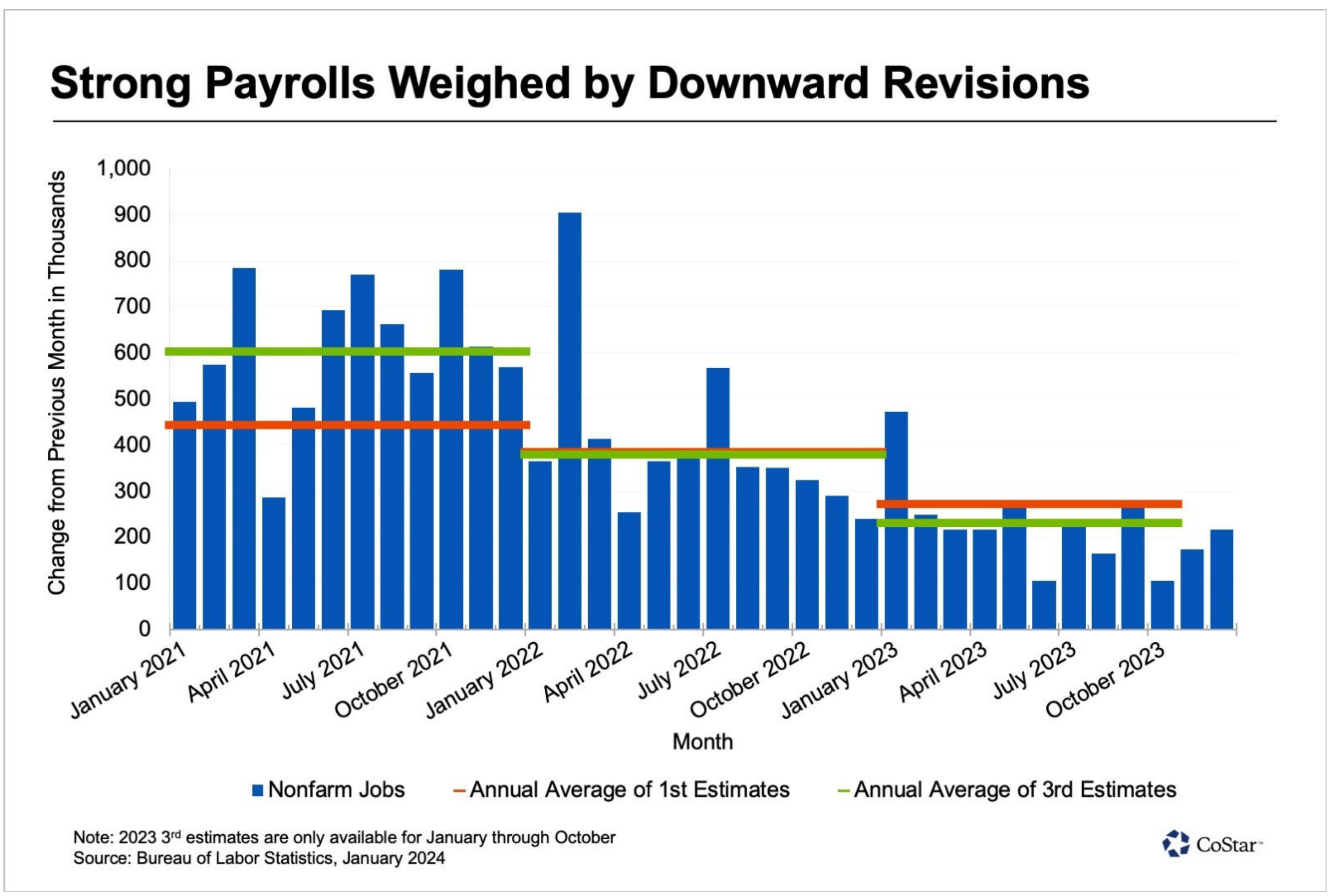
The labor market continues to show resilience, a positive sign of demand for commercial real estate space across property types as we begin the new year.

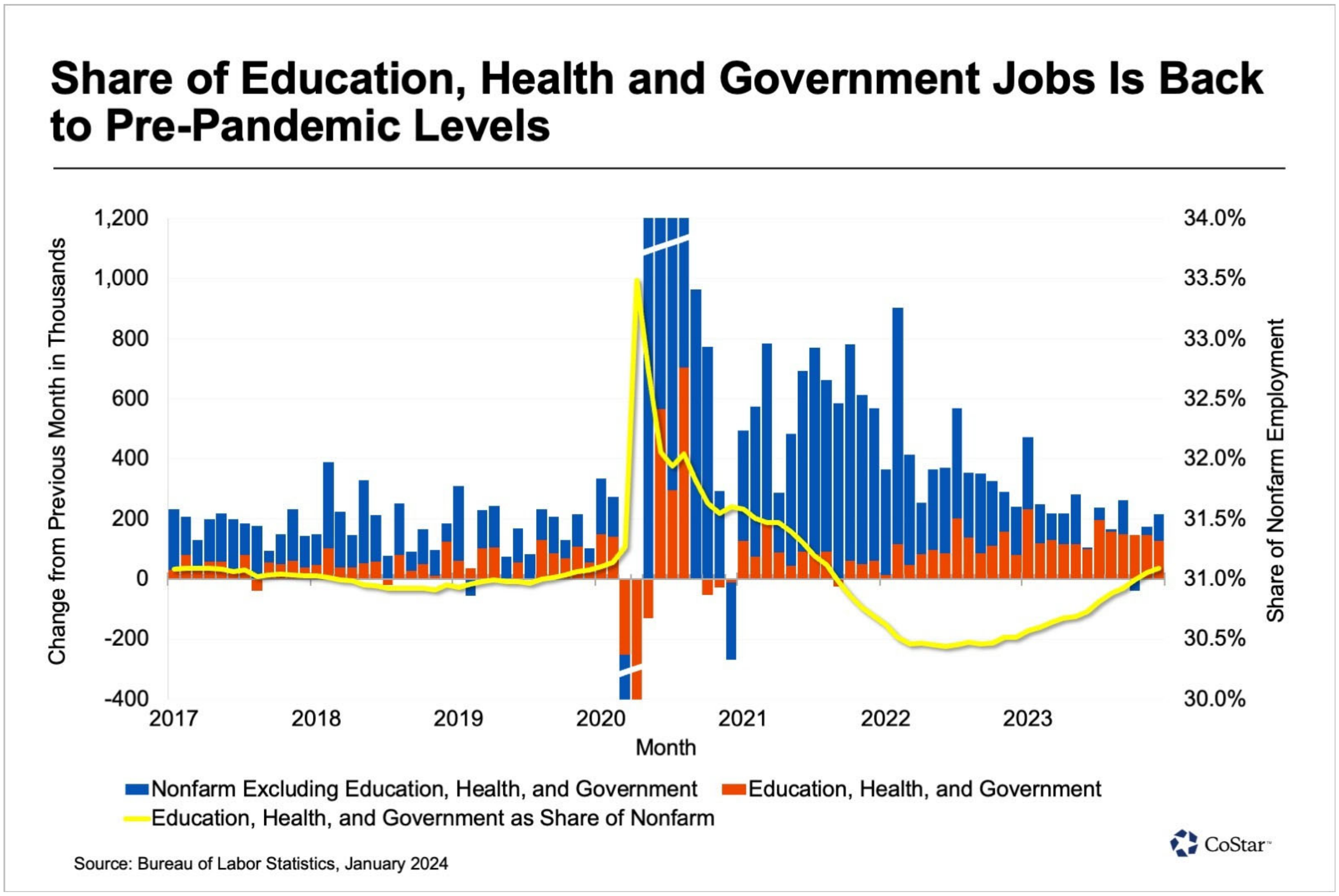
Firms added 216,000 positions in December, according to the Bureau of Labor Statistics, well above the average number of monthly job gains in pre-pandemic times. Wages continued to grow as well. Average hourly wages gained 0.4% in December, likely outpacing the rate of inflation for the third consecutive month.

Beneath the surface, however, the job market is showing several signs of cooling. First, employment estimates have become less reliable than in past years due to the business births-deaths model, which adjusts for a known bias in the BLS's data collection related to new businesses that form and add employees and failing businesses that close their doors. As a result, recent estimates of employment gains have been routinely adjusted lower in later releases.

November's job figures, for instance, were revised lower by 26,000 positions, from 199,000 jobs to 173,000 jobs. The prior month's figures were revised lower by 45,000 positions, from 150,000 jobs to 105,000 jobs. From January to October, when the third payroll estimates are available, downward revisions occurred in each month except for July, and have averaged 40,000 positions. In other words, the job growth figures initially reported each month in 2023 have been revised lower by 15% two months following their initial estimates.



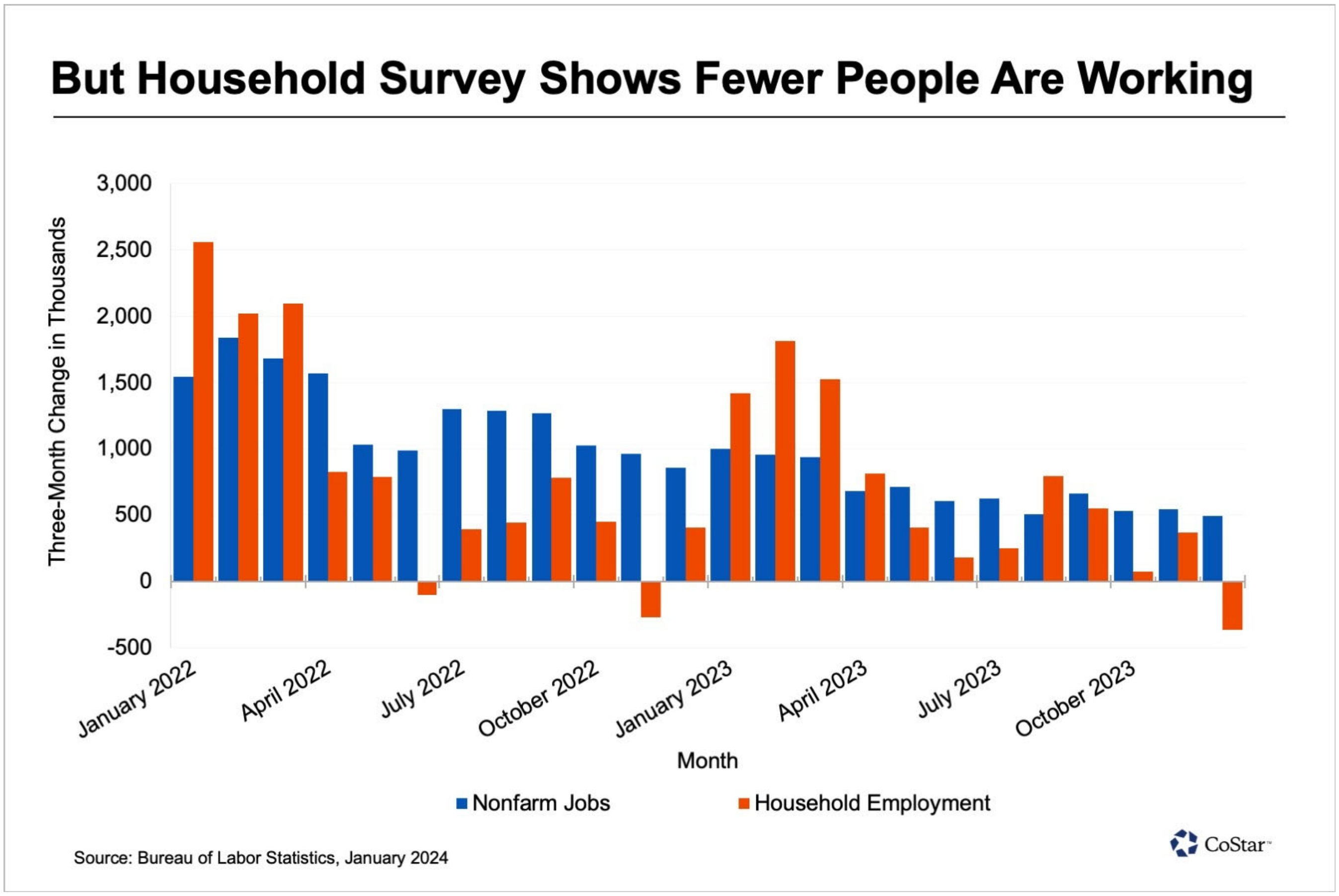
Downward revisions have affected some sectors more than others. While noncyclical sectors such as government, private education and healthcare have been providing the bulk of job growth, cyclical sectors have remained slightly positive. However, the revised October figures now show that payrolls in cyclical sectors fell by 40,000 positions that month.



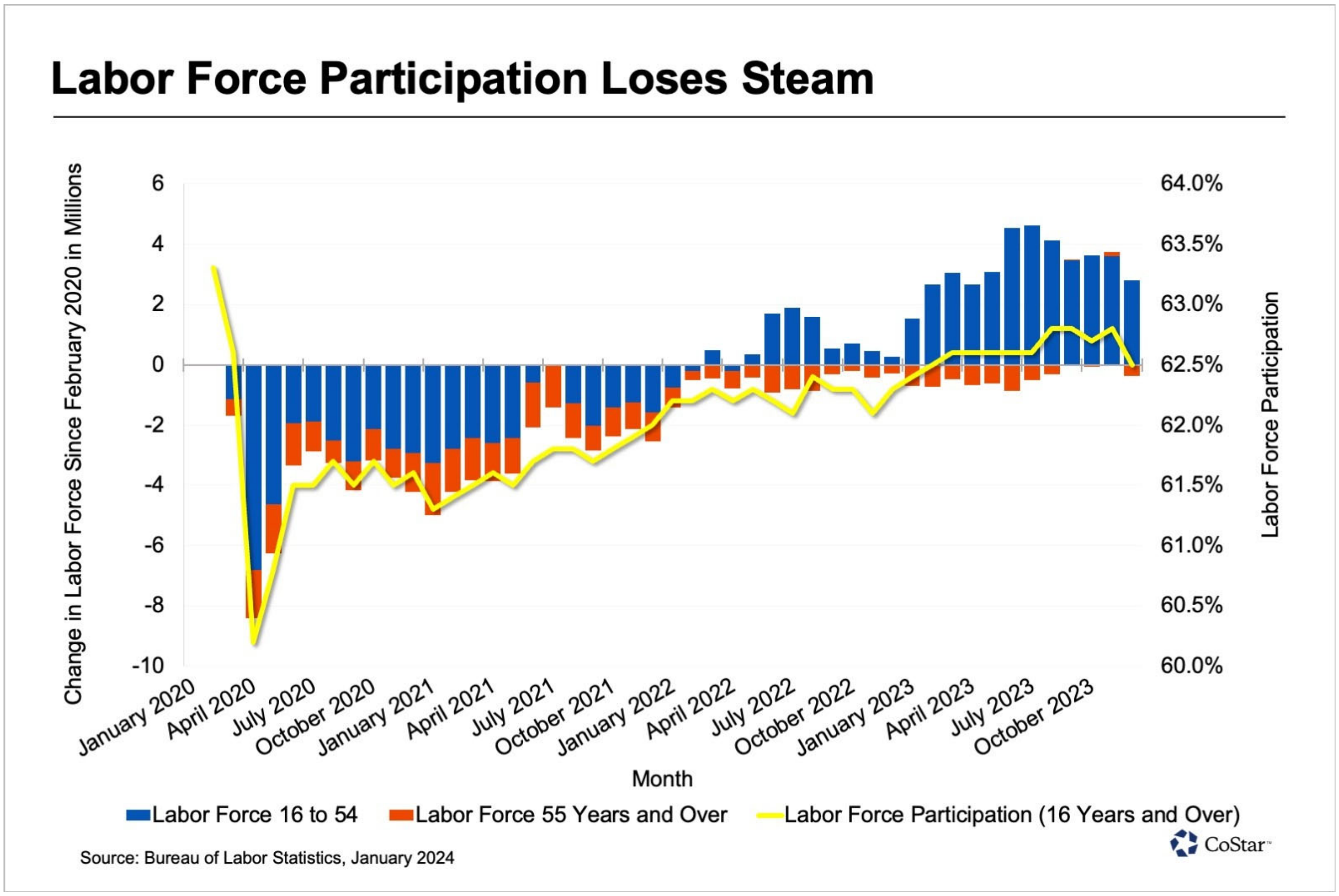
Furthermore, the slowdown in hiring in cyclical sectors could hinder job growth throughout the year. Over the past six months, 80% of jobs added to nonfarm payrolls have been in education, healthcare and government, accounting for 917,000 of the 1,157,000 jobs added over that period.

There is a cap on how much these sectors can grow because they are population-dependent, with demand for their services growing (or contracting) with the size of the population. Payrolls in these sectors currently account for 31% of nonfarm employment, approximately where they held steadily from 2015 to 2019. This suggests that noncyclical firms won't continue to hire throughout 2024 at the same rate as they did late last year.

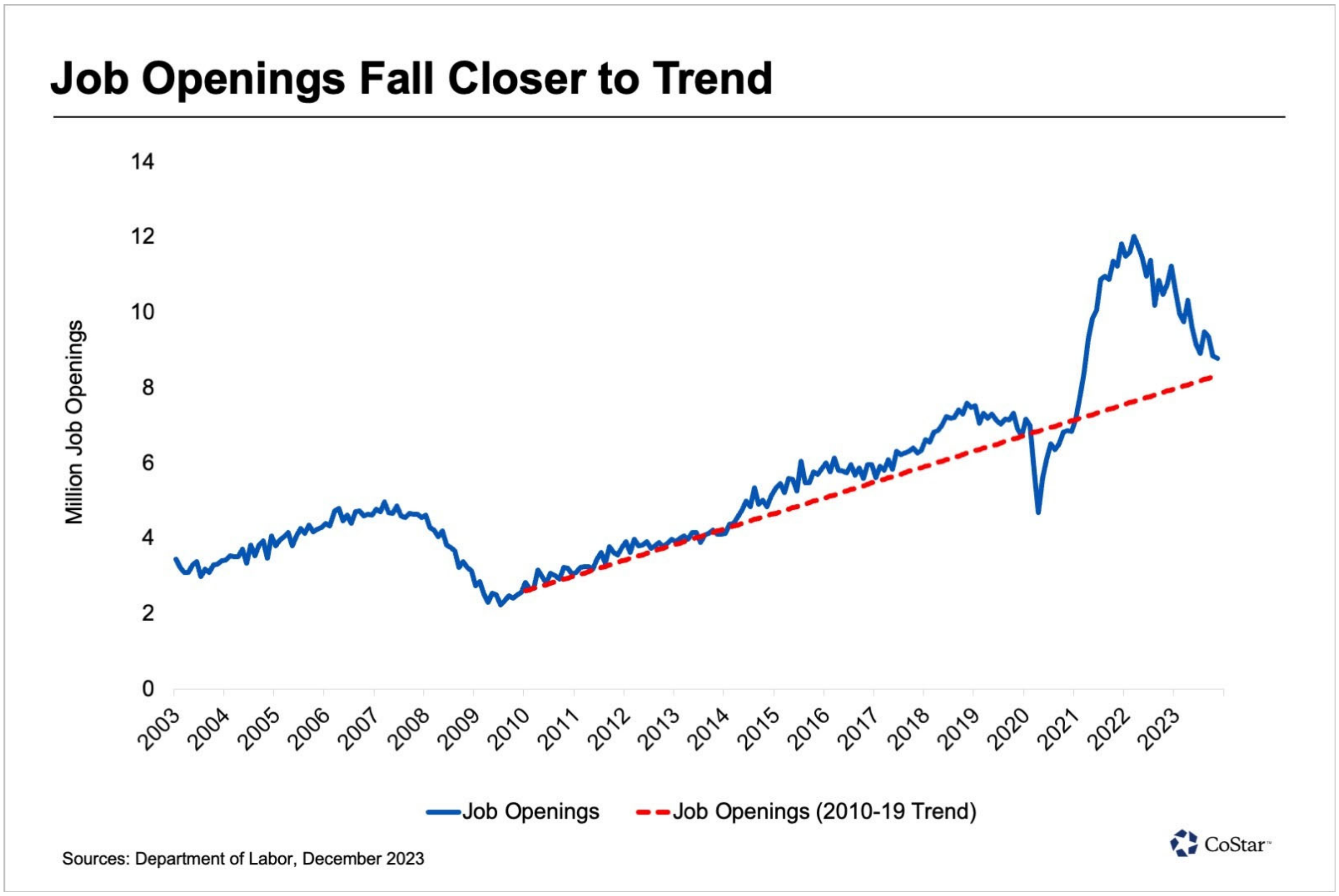
The household survey, which tracks the employment status of residents rather than counting actual jobs, reported that 367,000 fewer people were employed in December compared to October, in contrast to payrolls which have grown by 494,000 positions over the three-month period.



The household survey is generally less reliable due to its smaller sample size and recent low response rate. Still, it's a data point that suggests that employment levels may not be as robust as reported in the establishment survey. The household survey showed that labor force participation fell sharply in December to 62.5%, erasing gains that had kept the rate higher since March. The combination of fewer employed people and the lower participation rate left the unemployment rate at 3.7% in December, unchanged from the prior month.



Another sign that the labor market is cooling comes from the recent decline in job openings, which have fallen to 8.8 million in November 2023 from 10.7 million in November 2022, an 18% decline over a year ago. Job openings remain higher than their pre-pandemic peak of 7.5 million in January 2019, though they have been steadily growing from their trough in 2009. Job openings now are only slightly above their pre-pandemic trend.



This was confirmed by the December survey of small businesses conducted by the National Federation of Independent Business (NFIB), which found that the net percent of firms surveyed planning to add more employees fell from 18% in November to 16% in December, the third lowest percentage since mid-2020.

The survey is fielded to the members of the NFIB, which is almost entirely small businesses with fewer than 50 employees. Firms of this size accounted for more than half of private sector job gains in 2023, according to ADP, a payroll services provider.

What We're Watching ...

The underlying softening of the labor market helps explain why the Federal Reserve has taken a more dovish tone in its commentary recently. Yet wage growth is still a bit too hot for the Fed's comfort, so we can expect to see the panel's voting members sit tight for a while before cutting its policy rate.

With this latest rather robust jobs report, many market watchers pushed back their expectations of when the first rate cut will come this year, from March to May, while others are looking at an even later start date. On the other hand, should inflation ease more quickly than expected, the Fed might become concerned about being overly restrictive in its policy stance.

We may know more about the Fed's plans following the group's meeting at the end of January. This year looks to be one when fortuitous timing and delicate fine-tuning are both needed.

CoStar Economy is produced weekly by Christine Cooper, managing director and chief U.S. economist, and Rafael De Anda, associate director of CoStar Market Analytics in Los Angeles.

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